

Office of Chief Counsel
Internal Revenue Service

memorandum

TL-N-3232-99

JForsberg

date: September 27, 1999

to: Chief, Examination Division, North Central District
Attn: Wanda Gorell

from: District Counsel, North Central Region

subject: [REDACTED]
Sequa Interest Claim

This is in response to your request for advice as to the dates from which interest accrues on the deficiencies assessed for the [REDACTED]'s taxable years [REDACTED] and [REDACTED].

Issue

Under the facts set forth below, from what dates does interest accrue on the deficiencies assessed for [REDACTED]'s taxable years [REDACTED] and [REDACTED]?

Conclusion

Where a taxpayer has reported an overpayment on its return for year 1 and has elected to have the overpayment applied to its estimated taxes for year 2, and where a deficiency is assessed for year 1 in an amount which is less than the amount of the overpayment, interest does not accrue on the deficiency until, and only to the extent, the overpayment has been reduced below the amount of the deficiency by having been applied to year 2's estimated taxes, or, to the extent the overpayment is not fully used to satisfy year 2 estimated taxes, until the original due date of the year 2 return.

In this case, interest accrues as follows: With respect to the [REDACTED] deficiency, interest accrues on \$ [REDACTED] of deficiency from January 15, [REDACTED] (due date of the [REDACTED] third quarter estimated tax payment), on \$ [REDACTED] of deficiency from April 15, [REDACTED] (due date of the [REDACTED] fourth quarter estimated tax payment), and on the remaining \$ [REDACTED] of deficiency from July 15, [REDACTED] (original due date of the [REDACTED] return). With respect to the [REDACTED] deficiency, interest will accrue on \$ [REDACTED] of deficiency from January 15, [REDACTED] (due date of the [REDACTED] third quarter estimated tax payment) and on the remaining \$ [REDACTED] of deficiency from July 15, [REDACTED] (original due date of the [REDACTED] return).

Facts

██████████ (the "taxpayer") has a taxable year ending April 30. Pursuant to extension, the taxpayer's ██████ return was timely filed on or about January 3, ██████. The ██████ return showed a tax liability of \$██████████, and an overpayment of \$██████████, which the taxpayer elected to apply to its ██████ estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied. Accordingly, the overpayment was applied to the first quarterly estimated tax payment for ██████ pursuant to Rev. Ruling 88-98, 1988-2 C.B. 356.

██████████ made the following estimated tax payments for ██████:

<u>Installment Period</u>	<u>Estimated Tax Due¹</u>	<u>Estimated Tax Payment</u>	<u>Overpayment/ (Underpayment)</u>
August 15, ██████	\$██████████	\$██████████	\$██████████
October 15, ██████	██████████	██████████	██████████
January 15, ██████	██████████	██████████	(██████████)
April 15, ██████	██████████	██████████	(██████████)
	<u>\$██████████</u>	<u>\$██████████</u>	<u>\$ (██████████)</u>

The third and fourth quarterly estimated tax payments would have been underpaid without the application of the overpayment.

Pursuant to extension, the taxpayer's ██████ return was timely filed on or about January 16, ██████. The ██████ return showed a tax liability of \$██████████, and an overpayment of \$██████████, \$██████████ of which the taxpayer elected to apply to its ██████ estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied. Accordingly, the overpayment was applied to the first quarterly estimated tax payment for ██████ pursuant to Rev. Ruling 88-98.

¹ The quarterly estimated tax payments due are per the taxpayer's protective claim dated July 15, ██████. We have not verified the correctness of the taxpayer's computation.

² The taxpayer's claim dated July 15, ██████, show the fourth quarterly estimated tax payment as \$██████████, not \$██████████.

██████████ made the following estimated tax payments for
██████████:

<u>Installment Period</u>	<u>Estimated Tax Due³</u>	<u>Estimated Tax Payment</u>	<u>Overpayment/ (Underpayment)</u>
August 15, ██████████	\$ ██████████	\$ ██████████	\$ ██████████
October 15, ██████████	██████████	██████████	██████████
January 15, ██████████	██████████	██████████	(██████████)
April 15, ██████████	██████████	██████████	██████████
	\$ ██████████	\$ ██████████	\$ (██████████)

██████████'s ██████████ and ██████████ returns were subsequently examined and additional deficiencies in tax of \$ ██████████ and \$ ██████████ were assessed on ██████████. In computing the amount of interest due on the deficiencies for ██████████ and ██████████, the service used August 15, ██████████, and August 15, ██████████, respectively (the due dates of the taxpayer's first estimated quarterly tax payments for ██████████ and ██████████) as the dates on which interest began to accrue on the deficiencies.

On ██████████, the taxpayer filed protective claims for deficiency interest for ██████████ and ██████████ based on the May Department Stores and Sequa Corp. cases. Subsequently, in an attempt to comply with May Department Stores v. United States, 36 Fed. Cl. 680 (1996), the overpayments were applied to the subsequent year's third quarterly estimated tax payments. Interest for ██████████ and ██████████ was then computed from January 15, ██████████, and January 15, ██████████, the due dates of the taxpayer's third estimated quarterly installments for ██████████ and ██████████. In ██████████, the excess interest was abated.

Discussion

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), 1996-2 U.S.T.C. ¶ 50,596, acq. 1997-2 C.B. 1, the taxpayer elected to credit an overpayment shown on its 1983 return to its 1984 estimated tax liability but failed to designate the quarterly payment to which the overpayment was to be credited. The Service subsequently determined a deficiency for 1983 and assessed interest on the deficiency from the due

³ The quarterly estimated tax payments due are per the taxpayer's protective claim dated July 15, ██████████. We have not verified the correctness of the taxpayer's computation.

date of the first installment for 1984 in accordance with Rev. Rul. 88-98. The taxpayer, however, had made estimated tax payments for the first and second quarters of 1984 sufficient to avoid the addition to tax imposed by section 6655. The Court of Federal Claims held that the Government had had the use of taxpayer's overpayment from the due date of the first installment to the date taxpayer filed its 1983 tax return since the overpayment was not needed to satisfy either the first or second estimated tax payments.

In light of May Department Stores, the Service has modified the manner in which it will compute interest on a deficiency for a year where the taxpayer elected to apply an overpayment shown on that year's return to the succeeding year's estimated taxes. Rev. Rul. 99-40, 1999-40 IRB 1 (September 16, 1999) provides that in such a case, the overpayment will be applied to the unpaid installments of estimated tax due on or after the date the overpayment arose in the order in which they are needed to avoid the imposition of an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. Interest on the subsequently determined deficiency will then accrue from the date, and to the extent, the unapplied overpayment is no longer adequate to satisfy the deficiency. In determining when an overpayment is to be applied to estimated tax installment, any excess payments made for prior installments are to be taken into account.

Rev. Rul. 99-40 does not address the issue of when interest begins to accrue on a deficiency where all or part of the overpayment is not needed to satisfy the succeeding year's estimated tax liability. It is the Service's position that in such a case, the overpayment should be treated as a payment of the succeeding year's income tax. Section 6513(d) provides:

If any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year), and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises.

Under sections 6513(a) and 6151, the due date of the succeeding year's return is the last date on which an overpayment could be credited as a payment of the succeeding year's tax. Further, this is also the date the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under sections 6611(a) and (d). Accordingly, the statute requires that an overpayment which

the taxpayer elects to credit against the succeeding year's estimated tax must be treated as a payment against the succeeding year's tax liability no later than the due date of the succeeding year's return.

In the present case, the taxpayer's [REDACTED] overpayment would be applied as follows:

[REDACTED] Overpayment	\$ [REDACTED]
Applied to 1st Quarter Payment	<u>-0-</u>
Unapplied Overpayment as of [REDACTED]	[REDACTED]
Applied to 2nd Quarter Payment	<u>-0-</u>
Unapplied Overpayment as of [REDACTED]	[REDACTED]
Applied to 3rd Quarter Payment (\$ [REDACTED] (required estimated tax payment) - (\$ [REDACTED] (third quarter estimated tax payment) + \$ [REDACTED] (excess first quarter payment) + \$ [REDACTED] (excess second quarter payment))	[REDACTED]
Unapplied Overpayment as of [REDACTED]	[REDACTED]
Applied to 4th Quarter Payment (\$ [REDACTED] - \$ [REDACTED])	[REDACTED]
Unapplied Overpayment as of [REDACTED]	[REDACTED]

Prior to the due date of the third quarterly installment for [REDACTED] on January 15, [REDACTED], the amount of the unapplied overpayment for [REDACTED] (\$ [REDACTED]) exceeded the deficiency for [REDACTED] (\$ [REDACTED]). Accordingly, no interest accrues on the [REDACTED] deficiency prior to that date. On January 15, [REDACTED], \$ [REDACTED] of the overpayment must be applied against the [REDACTED] third quarterly installment to avoid the imposition of an estimated tax penalty. Thereafter, the unapplied overpayment is no longer sufficient to cover \$ [REDACTED] of the [REDACTED] deficiency (\$ [REDACTED] - [REDACTED]). Thus, interest begins to accrue on \$ [REDACTED] of the [REDACTED] deficiency on January 15, [REDACTED]. On April 15, [REDACTED], \$ [REDACTED] of the [REDACTED] overpayment must be applied against the [REDACTED] fourth quarterly installment, thereby further reducing the amount of the unapplied [REDACTED] overpayment available to cover the [REDACTED] deficiency. Thus, interest begins to accrue on another \$ [REDACTED] of the [REDACTED] deficiency on April 15, [REDACTED]. Interest on the remaining \$ [REDACTED] of the [REDACTED] deficiency would then begin to accrue on July 15, [REDACTED], the unextended due date of the [REDACTED] return.

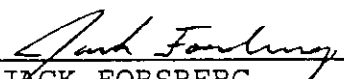
- 6 -

The dates on which interest begins to accrue on the taxpayer's [REDACTED] deficiency would similarly determined.

If you have any questions respecting this matter, please call Jack Forsberg at (651) 290-3473, ext. 227.

REID M. HUEY
District Counsel

By:


JACK FORSBERG
Special Litigation Assistant

cc: Assistant Chief Counsel
(Field Service)